

Economic Trends

Alberta economy sustains momentum

Alberta's economy has continued to perform very well into the spring of 2014 following a strong 2013. Business sector output expanded at a solid clip in the first quarter, while consumer spending and housing market activity have picked up notably in recent months. This month's *inFocus* takes a closer look at Alberta's food manufacturing sector.

Household Sector

Employment tracking well above 2013 levels

A rapidly expanding labour market is driving household activity in the province. While job growth paused in March and April, this comes after a sharp run-up in the first two months of 2014. Year-to-date employment is up 3.6% over the same time last year, well above the 0.4% increase in the rest of Canada.

Consumer spending pushes higher
Retail sales point to high levels of consumer confidence in Alberta.

Key Indicators

Seasonally adjusted unless otherwise indicated.

Indicator	Latest Month	Value	Change year-over-year (y/y)
Employment (thousands)	April	2,258	+3.3%
Unemployment Rate	April	4.7%	+0.3 p.p.
CPI Inflation (unadjusted)	April	2.7%	+1.4 p.p.
Retail Sales	March	\$5.6B	+11.1%
Housing Starts (annualized)	April	39,734	+0.6%
Rigs Drilling (unadjusted)	May	115	+29.7%
Manufacturing Shipments	March	\$6.6B	+11.3%
Exports (unadjusted)	March	\$10.3B	+18.6%

Source: Statistics Canada, CAODC, CMHC. p.p.= percentage points.

Year-over-year sales growth in March was 11.1%, the highest since June 2007, and accounting for 42% of Canada's overall increase. Growth in 2014 has been primarily driven by spending at gasoline stations and motor vehicle and parts dealers, with higher gasoline prices and soaring in-migration playing key roles. Substantial increases

have also been recorded at home furnishing, general merchandise and food and beverage stores.

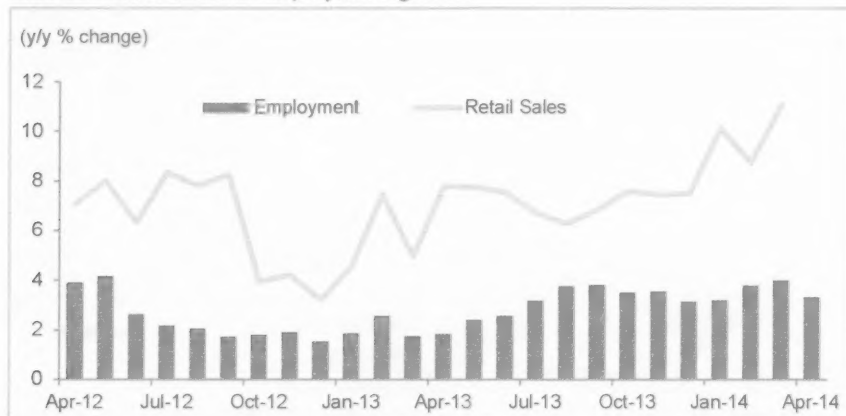
Rising demand fuels housing

Household activity in Alberta is not confined to retail spending as the housing market also continues to climb. Existing home sales are strong, with year-over-year growth averaging 11.1% per month since May 2013. Strong demand, in part driven by in-migration, has put upward pressure on prices. Resale prices are up 5.9% year-to-date. Calgary's market in particular has heated up, with home price growth accelerating to 9.1% so far this year according to the quality-adjusted Teranet index. In April, the number of completed, but unabsorbed housing units in Calgary reached its lowest level since April 2007 and the resale market remained firmly in seller's territory.

Shelter costs propel inflation

Shelter costs are trending upwards, boosting inflation in Alberta. Rents and owned accommodation costs have accelerated this year, rising 2.8% and

Chart 1: Surging retail sales supported by continued job growth
Alberta retail sales and employment growth



Source: Statistics Canada

3.6% year-to-date over the same time last year. Higher natural gas prices, especially in March, have also played a key role in pushing up shelter costs. Year-to-date consumer inflation sits at 2.9%, well above 2013's 1.4% reading.

Alberta Business Sector

Output jumps in first quarter

The value of Alberta exports accelerated in the first quarter of 2014, up 8.3% over the previous quarter, and 16% above the same time last year. The value of natural gas exports has jumped in recent months with slightly higher production coinciding with substantially higher prices relative to the previous year, along with a lower valued Canadian dollar. Likewise, the value of oil production continues to break records, with output and prices both edging higher.

Manufactured product sales have been trending sharply higher since mid 2013 and started 2014 with 8.4% y/y growth in the first quarter. Petroleum & coal shipments, the largest category, and chemical products have both noted double digit year-over-year growth so far this year. Machinery has rebounded sharply since a late 2012 slump, growing 14.4% y/y in the first three months of the year. Machinery

shipments in March were the third highest reading on record.

In situ methods to propel Alberta's oil production

Crude oil production in Alberta is expected to reach 4.5 million barrels per day by 2023, according to the recently released St-98 outlook report by the Alberta Energy Regulator (Chart 2). In situ oil sands production is expected to expand much more quickly than mining, as the bulk of Alberta's 167 billion barrels of established reserves are recoverable through this method and carry a lower supply cost (per barrel) than mining. The report noted that 53% of raw bitumen extracted in Alberta was from in situ production in 2013, and the share is expected to rise to 59% by 2023. Conventional oil production, which has rebounded over the last four years, is expected to hold fairly flat over the forecast period.

Warmer weather benefits rail shipments

Spring temperatures appear to be lifting rail volumes from Western Canada. Rail car movements jumped by 23.2% in March over February, well above the typical increase for that month. This comes after exceptionally cold weather negatively affected rail volumes in the

first two months of the year. In addition, more of last year's bumper crop appears to be getting to market, with March carloads of wheat and canola increasing by 22.7% and 61.2% over the same month last year. Shipments of crude products continued their strong upward trend, increasing 46.3% y/y in the first quarter.

Global Economy

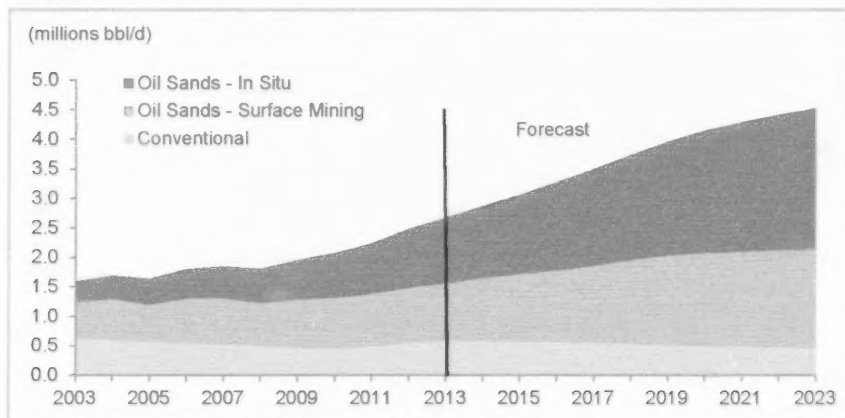
Chinese economy wobbles as exports falter

Economic growth in China slowed in the first three months of 2014, but appears to be stabilizing. Exports in the first quarter were down 6.0% from the same quarter of 2013, the worst performance since the 2008-9 recession. The cold winter weather, which weighed on the US economy, likely also hurt China's exports. Some bounce-back is expected with the arrival of spring. There is some evidence that this is already happening. April exports were up slightly from a year ago and the Purchasing Managers' Index (PMI) for China rose to 48.1, the highest reading in five months, suggesting that fewer firms are seeing worsening business conditions.

Bank of Canada back on target

For the first time in two years, inflation has returned to the Bank of Canada's 2% target. This is up from 0.7% in October 2013 when persistently low inflation prompted the Bank of Canada to raise the possibility of an interest rate cut if prices did not start to increase. The potential for lower rates played a role in the Canadian dollar losing more than five cents against the US dollar. Despite an improving inflation outlook, the Bank has maintained its stance, noting that much of the increase is due to energy prices, especially natural gas. Excluding the eight most volatile components of CPI, inflation is still well below target at 1.5%.

Chart 2: Oil sands production ramping up
Alberta Oil Production



Source: Alberta Energy Regulator, ST-98 May 2014

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inFocus

Recent trends in Alberta food manufacturing

Food manufacturing is Alberta's third largest manufacturing industry, with revenues totaling an estimated \$11.5 billion in 2013. The industry moves Alberta's agriculture commodities up the value chain, converting them into food. Shipments of manufactured foods in Alberta have risen by 2.8% a year between 2003 and 2013, below the 4.4% growth in the overall manufacturing sector. In terms of value-added production, food industry's real GDP growth has been 2.5% per year over this period, roughly in line with the broader manufacturing sector.

Underneath these headline results are two diverging patterns. The food industry's growth has come almost entirely from non-meat products, notably milled grains and oilseeds but also dairy products and animal foods (Chart 1). Meat product manufacturers, which still make up half of Alberta's food manufacturing shipments, have seen lackluster growth. Meat producers have been hampered by a number of export challenges, including export bans due to isolated cases of BSE and the introduction of US Mandatory Country of Origin Labeling (MCOOL).

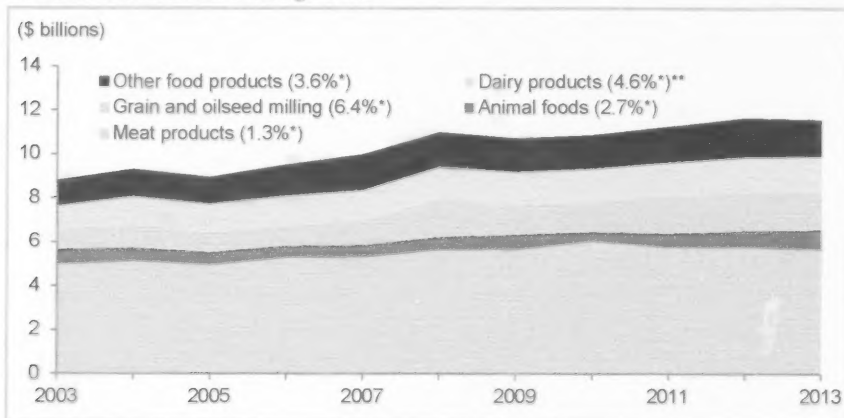
Strength concentrated outside of meat manufacturing

Food products other than meat have driven industry gains over the last ten years. Non-meat shipments of food, which includes dairy, animal food, and grain and oilseed milling, have grown by 4.4% a year since 2003, roughly the same rate as overall manufacturing sales in the province (Chart 2). The strongest contributor has been grain and oilseeds industry, where sales have surged 6.4% per year and real GDP by 10.9% a year over the past decade. Sales growth over this period has also been strong for dairy products (4.6%).

International markets have fueled growth in non-meat food manufacturing. Alberta exports of these products have increased 7.3% per year over the last decade,

Chart 1. Grain and oilseed milling post largest gain

Alberta Food Manufacturing Sales



Source: Statistics Canada

* 10-year compound annual growth rate

** 2005-2012 data unavailable, series interpolated based on available data

Industry Profile

Food manufacturing is the processing of raw agricultural products into intermediate or final consumption goods. Steaks, flour, canola oil and dog food are all examples of the types of products manufactured within Alberta.

Food manufacturing shipments were \$11.5 billion in 2013, representing 16% of total manufacturing in Alberta. Meat products made up nearly half (49%) of food manufacturing sales in Alberta last year, although this share has been declining. Beef product rendering is the largest component of meat processing, followed by pork products.

Grain & oilseed milling (14.7%), dairy (14.3%) and animal food manufacturing (7.7%) make up the other largest industries of food manufacturing. Rising grain and oilseed production in Alberta has benefited millers, giving them easy and local access to ingredients. Similarly, specialty pet foods, and livestock feed have noted substantial sales increases.

Statistics Canada recommends that annual data be used. However, annual data for the time period of interest (2003 and 2013) were not available at the time of. As a result, monthly seasonally unadjusted data were summed to derive the annual estimates. These are preliminary estimates only and will change when the annual series are released.

out-pacing the national gain of 4.3%, and driven heavily by animal foods and grain and oilseed milling. Alberta's animal food manufacturing exports to the United States have increased nearly 10 fold since 2003 to almost \$100 million. Grain and oilseed milling have noticed a 6.1% annual increase of exports to the US, and a staggering 39.6% annual increase in exports to China. In fact, China has been the largest export destination for starch and vegetable fat and oil manufacturing, the principle derivative of oilseed processing.

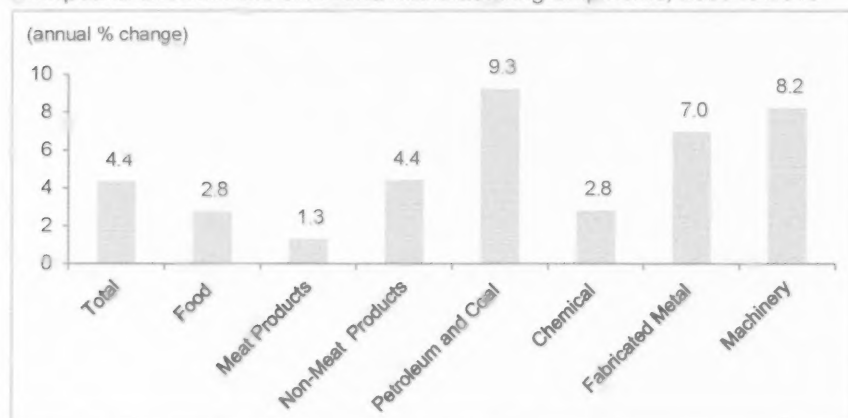
Meat manufacturing held back by export challenges

Alberta's meat manufacturing industry, in contrast, has seen little growth over the last decade, with sales increasing 1.3% per year since 2003 (Chart 3). The primary source of weakness has been sluggish international exports. Alberta's cattle and meat production industry has faced challenges due to a previous isolated episode of livestock illness. In 2003, a positive test for Bovine Spongiform Encephalitis (BSE) in a lone cow at an Alberta farm resulted in widespread import bans for Alberta beef products. Some markets are still not fully open, including Mexico

and Japan. The value of exported meat products felt the impact, with a pronounced drop from previous highs across almost all export destinations. Another obstacle to growth has been Mandatory Country of Origin Labeling imposed by the US government since 2009, which has significantly raised industry costs. Despite sharp increases in prices since 2009, the value of meat product exports remain below their 2005 levels.

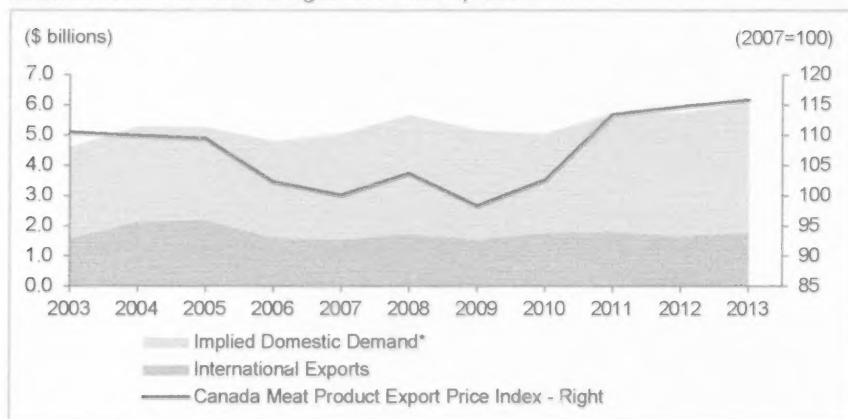
In more recent months, prices for cattle and meat products have increased sharply, in large part due to declining cattle stock in the United States, which currently sits at a 63 year low. Higher prices should support Alberta's meat product sales in 2014.

Chart 2. Growth in food manufacturing held back by meat products
Compound Growth Rate of Alberta Manufacturing Shipments, 2003 to 2013



Source: Statistics Canada

Chart 3. Meat manufacturers hampered by sluggish exports
Meat Product Manufacturing Sales and Exports



Source: Statistics Canada

* Total shipments less international exports

Investment rebounds

Capital spending in food manufacturing has turned the corner, rebounding sharply after a pronounced descent between 2005 and 2010. Investment hit \$177.5 million in 2013, the highest level since 2000. Statistics Canada's survey of intentions suggest that investment should remain near this level in 2014.

Opportunities abound

There are growth opportunities for Alberta's food manufacturing industry going forward. The industry has made inroads to fast-growing emerging markets, such as China, where continued gains are likely. The Trans Pacific Partnership, where discussions are ongoing, presents opportunities to reduce barriers to trade in Asian markets. Recent trade agreements, namely the Canada-South Korea Free Trade Agreement and the proposed Canada-European Union Comprehensive Economic Trade Agreement, reduces or eliminates tariffs on a number of agriculture products and further opens trade with these major markets.

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